Chapter-3

PROCEDURE FOLLOWED

IN PREPARATION OF

THE REPORT

&

STUDIES UNDERTAKEN

3.1. PROCEDURE FOLLOWED

3.1.1 The PRC held Thirty Nine sittings **(Annex - 3.1).** The first meeting of the PRC was held on 13th December, 2006 at New Delhi where, among other deliberations, the strategy to be adopted for studying the existing market scenario and issues related to compensation packages for the PSEs executives, were discussed.

3.1.2 The approach adopted included analysis of the existing compensation packages in the CPSEs/Relevant Private Sector Companies etc by obtaining feedback in a structured manner through a questionnaire **(Annex - 3.2)** from Management as well as Officers' Associations of CPSEs, administrative Ministries/Departments, eminent individuals/consultants Association with CPSEs, special organizations like BIFR, PESB, 6th Central Pay Commission, Employers' organizations and Professional Bodies such as SCOPE etc. Key issues covered in the Questionnaire are; Role of the Government, Scales of Pay & Uniformity in pay packages, Recruitment, Promotion, Flight of Talent, Composition of the package, Performance Related Payments, Increments, Issues of relativity and comparison with Government/Private sector/International – criteria for determination of emoluments/compensation packages, Issue of resources, Central Dearness Allowance (CDA)/IDA related issues, Pay revision in Sick/BIFR referred CPSEs, number of Holidays, Voluntary Retirement Scheme, City Compensatory Allowance, Performance Appraisal etc.

3.1.3 The Committee also decided to take the opportunity of meeting the management of CPSEs belonging to different sectors and their Officers' Associations to gather their views on the compensation related issues. In the process, 30 CPSEs, 38 Officers' Associations and 20 other Agencies/Department have made presentations before the PRC **(Annex - 3.3).**

3.1.4 The Committee also had a meeting with the Sixth Central Pay Commission, wherein issues of common interest were discussed.

3.1.5 In addition, Institute of Public Enterprises, Hyderabad has also been engaged to conduct a study of current market trends in the Private sector as well as CPSEs of few leading countries, where CPSEs exist along with thriving Private sector companies.

3.1.6 The Committee also identified few compensation related issues and desired that thematic studies on these issues need to be carried out. Thereafter, approach papers can be presented with a futuristic view. The issues identified were:

(i) IDA/CDA Pattern
(ii) Entry Level Compensation
(iii) Performance Related Payments
(iv) Employee Stock Option Plans [ESOP]
(v) Voluntary Retirement Scheme
(vi) Retirement Benefits

3.1.7 The Committee also took note of the studies conducted by SCOPE through M/s Mercer Consultants and the one commissioned by oil companies through M/s Hewitt Associates.

3.1.8 The Committee was also assisted by number of Executives from various CPSEs. The detailed list is at **Annexe- 3.4.**

3.2. RESPONSES TO QUESTIONNAIRE

3.2.1 The PRC undertook the exercise of collecting and assimilating the primary source of information pertaining to existing compensation and benefits from various agencies so that the views of the stakeholders, who are likely to be affected by the decisions taken by the PRC are made available. Based on the replies received from 184 different agencies (**Annex.-3.5)** including 111 CPSEs and their subsidiaries, 44 Officers' Associations; 19 Ministries/Departments and 10 Consultants/Task Force members, a detailed analysis has been done on each of the question and is given at **Annex.- 3.6**. However, a brief summary of the replies has been prepared and is as under:

- **a.** On the role of the Government as owner in the current context, 44% CPSEs have favoured for complete autonomy in the pay structure, while nearly 66% of the CPSEs felt that there should be broad guidelines for pay structure but the issue of finalization of perquisites may be left to the individual organization.

- **b.** Regarding the Scales of Pay & uniformity in pay packages, majority i.e. 82% of the CPSEs, are against the uniformity of the pay scales in all CPSEs though uniformity within one schedule is welcomed.

- **c.** On composition of the compensation package, it should be structured in such a manner so that the tax liability on the part of employee is reduced. 55% organizations are of the view that present system of Fixed Pay + Perks may continue. Further, another 65 % have advocated for the fixed and variable components of Salary.

- **d.** Regarding incentive to the Members of the Board of Directors, 88 % advocated for payment of incentive (Profit sharing). Overall, 40% wanted that the incentive to Members of the Board to be decided by the concerned CPSE.

- **e.** Most CPSEs are inclined towards open-ended scales, whereas others have suggested the ratio ranging from 1:15 to 1:20.

- **f.** Most of the respondents have asked for parity with the private sector / market or freedom for CPSEs to structure their compensation packages with only broad guidelines being issued by the Government. Majority of Officers' Associations have also sought parity in compensation with the private sector / market

- **g.** 75 % of the organisations were in favour of Performance Related Payments and have set the Organisations Performance, Groups Performance (Performance of Business Unit), Productivity and Profit as the Criteria for such payments.

- **h.** The relativity in remuneration between the top management & workmen, as recommended by CPSEs, is maximum at 35:1. So far as Officers' Associations are concerned, they recommended a maximum of 25:1.

i. Regarding fair comparison between the salaries available in the public sector vis-à-vis the private sector taking into account benefits like security of tenure, promotional avenues, retirement packages, housing etc., 30 % of CPSEs are of the opinion that the afore-mentioned benefits are available in the private sector also. 24% felt that Cost to Company (CTC) concept should be adopted to compare compensation in the public sector with the private sector. Most felt that focus has shifted from employment to employability. Officers' Associations are of the view that comparison of emoluments in the public sector with that existing in comparable private sector companies is fair as benefits like security of tenure, promotional avenues, retirement packages, housing etc are available in comparable private sector companies also and CTC in competing private companies is in fact higher.

3.2.2 Thus, it can be seen that CPSEs, particularly profit-making ones, are seeking closer relationship with the private sector for compensation issues. Another notable feature is the acceptance of increased role of Performance related payments and more thrust on variable pay as compared to fixed pay. The competitive spirit of CPSEs is also visible for attraction and retention of talent in the open market scenario through innovative use of pay, benefits, growth & development opportunities etc.

3.3. INTERACTIONS HELD

The Committee, held meetings with around 30 CPSEs, 38 Officers' Associations and 19 other bodies. The committee also met the Public Enterprises Selection Board [PESB]. The Sixth Central Pay Commission constituted for pay revision of central government employees, Board of Industrial & Financial Restructuring (BIFR) etc. Managements of CPSEs, which included Navaratna, Miniratna, Profit-making, loss-making as well as Sick units, their Officers` Associations, Federations were also given opportunity to express their views and related concerns before the Pay Committee.

During the process, elaborate presentations were made by the CPSEs/Associations and deliberations on significant factors for designing an appropriate compensation packages matching industry specific requirements were held. Interactions with the Sixth Central Pay Commission and PESB also gave an enlightened insight to some of the key issues that need to be addressed and incorporated in the compensation strategy for CPSEs. A broad spectrum of issues which came up during such deliberations as well as during discussions with a select population of CPSEs executives and need to be considered are being summarized below.

3.3.1 Certain Views Considered

During the deliberations of the Committee, different views were expressed in regard to the proposed classifications, in regard to parity with Salaries in Government and also as regards the proposal of different remunerations to different categories. The Committee considered all these views while making its recommendations, in the long term interest of CPSEs, keeping in view the specific mandate in the terms of reference of the Committee.

3.3.2 Meetings/Discussions with Management of CPSEs : The broad suggestions came out of these meetings are:

(i) Capacity to pay should be the principle with full autonomy to Board of Directors for taking need based decisions.

(ii) 50% IDA should be merged with Basic Pay w.e.f 1.1.05, the date on which IDA crossed 50%.

(iii) Open ended pay scales in order to avoid stagnation.

(iv) Rate of increment should be on percentage of Basic Pay and Promotional Benefit at the rate of double the proposed Rate of Increment.

(v) Government should provide broad guidelines for Salary Revision.

(vi) Introduction of Contributory Pension Scheme, Comprehensive Medical Coverage to employee and Spouse.

(vii) Uniformity of retirement age across all CPSEs, Enhancement of retirement age may be considered up to 62 years.

(viii) Periodicity of Pay revision to be in the range of 3-5 years.

(ix) Autonomy to be given to CPSEs to design their own VR schemes as per their requirements.

(x) Existing ESOPs guidelines issued by the DPE need to be modified to make it attractive and popular.

(xi) Boards should be allowed to function as per the provisions of Companies Act, 1956 and be empowered to decide as per prevailing circumstances exclusive to respective CPSEs.

3.3.3 Some CPSEs undertook separate studies through independent consultants on their own initiative. SCOPE undertook a study through **M/s Mercer Human Resource Consultant** and presented the findings before the Committee. The study while elaborating in detail the current scenario in which CPSEs are being encouraged to look for business growth in global markets, seek opportunities for expansion through mergers and acquisitions, seek Finance from open markets to fund their business plans, all with little support from the Government, calls for a paradigm shift of the basis for determining salaries and benefits policies in CPSEs and emphasizes that the rationale or foundation that forms the basis for establishing pay practices in CPSEs requires a serious rethink.

(i) In an environment, where CPSEs are competing head to head for business and growth opportunities in the open market with other employers, where the public sector is seeking to attract and retain employees that form a part of the same talent pool, determining the basis for pay should be based on an appropriate mix of the following factors such as Affordability or Capacity to pay; Job content; Cost of living; Market benchmarks for Pay and Benefits in comparable companies; Individual performance; Qualifications and Competencies. Need to set wages, organization wise, treating each CPSE as an individual entity with due regard to productivity has emerged as an important outcome of this study.

(ii) Other interesting outcome of the study is that Government should only articulate the ground rules or guidelines for companies to manage their own employee costs, concept of Remuneration Committee, Total Reward Strategy or Cost To Company

(CTC) Concept, Performance based compensation, periodicity of salary reviews, Provision of Retirement Benefits. Details of the studies are placed at **Annex.-3.7.**

3.3.4 Similarly, the Oil Sector CPSEs undertook study through **M/s Hewitt Associates** as 'Compensation and Benefits Benchmarking'. The study points out the need to adopt such remuneration strategies, which shall facilitate in enabling the CPSEs to compete with the global competitors attract and retain talents from among the common pool available and linkages with market salaries etc. Total Guaranteed Cash Compensation; autonomy in managing perks & allowances; sharing of profits; aggressive pay for performance even where profits are inadequate; a higher percentage of basic pay as performance based pay; introduction of an Employee Stock Option Plan (ESOP); Benchmarking Compensation once in at least 2 years; and differential increments based on performance in percentage terms are some of the key factors, which this study intends to take into consideration, while designing the overall pay package in CPSEs. Details of the studies are placed at **Annex.- 3.8.**

3.3.5 Meetings/Discussions with Officers' Associations of CPSEs : Major issues that were highlighted during these discussions were:

(i) Merger of 50% IDA with Basic Pay.

(ii) Interim Relief of minimum 15% of Basic Pay plus DA w.e.f. 1.1.2007 till finalization of salary revision.

(iii) CPSE employees to be treated at par with Central Government employees for housing perquisites.

(iv) Revised scales should take into account the increase effected in the last salary revision and incremental growth over the years.

(v) Rate of increment demanded ranges from 3% to 10% of Basic Pay and Promotional Benefit at double the proposed rate of increment.

(vi) Substantial increase in all perks and benefits applicable to executives.

(vii) Enhancement in the allowances linked to Basic Pay such as HRA/CCA/NPA etc.

switch over to IDA pay scale is voluntary. On the other hand, the Supreme Court held in the case of A.K.Bindal vs UOI (2003) that the economic viability or the financial capacity of the employer is an important factor, which cannot be ignored, while fixing the wage structure, otherwise the unit itself may not be able to function and may have h

where the employee works or in other companies or in both. Employee share ownership can take many different forms.

a. Employee stock option plan (ESOP)

Employee stock option plans are the most commonly used form for employee ownership. The rising use of ESOP comes in part from a tightening labour market for knowledge workers. The principle message conveyed to the employees through ESOP is that, if they stay long enough till vesting, they stand to gain significantly through exercising the options. ESOPs are generally offered by offering fresh equity resulting in dilution of stake-holder shares and an alteration in the company equity structure. The other method for offering ESOPs relates to formation of a trust, which buys company's equity from the open market for offering options to the employees as per the company policy.

b. Employee stock purchase plan (ESPP)

Under an employee stock purchase plan, stock is transferred to employees, usually at a discount to the market price. Under this scheme, full rights may be conditional and predicated on the occurrence of certain events e.g. continued employment and/ or achievement of certain business measures. During the restricted period, the employee enjoys full share-holder rights, except for the right to sell or transfer the shares.

c. Stock indexed plan (SIP)

Stock based incentive plans do not involve actual purchase and acquisition of stock to link employee rewards to the value of the company stock. The expenses incurred under this plan, have to be borne by the company. Consequently, it is treated as tax-deductible compensation expense in the books. These plans have three features that make them tremendously appealing to the shareholders. First, they only reward managers, who out perform the market. If a company uses these options, there is no risk that mediocre or even poor managers will be over compensated as a result of bull market. Second, because the strike price is not fixed and tends to rise every year, an indexed plan will transfer less value than a conventional stock option plan. Third, indexed plans have lower strike prices and higher values even in bad times making it easier to retain valuable employees just when they are needed most.

- **Stock appreciation rights (SAR)**

  Although, SARs are not technically employee stock options, companies often use them in a like manner. SARs provide employees with cash payments equal to the appreciation of the company's stock over a specified duration. Thus, unlike other options, SARs provide employees with equity upside without exposure to any downside. Also, options, SARs result in periodic payments of cash to the employees over the SARs life. These are subject to same accounting treatment as index options and, therefore, are avoided by managers.

- **Phantom stocks**

  Phantom stock is a form of long-term deferred compensation using the company stock as the measuring device for calculating the value of the deferred compensation. It simulates the company stocks in everything except that does not represent true ownership. The company simply credits these phantom shares on its books and as the value of the company stock rises and falls, so does the value of the phantom stock.

While the employee is benefited under all the above schemes, ownership, in varying degrees, is possible only through the stock options because under the profit sharing schemes, the 'employee' (us) vs. 'employer' (they) feeling remains. In view of this, various stock options have been compared on four major dimensions i.e. (i) company liability, (ii) dilution of stake of major shareholders (changes in the equity structure), (iii) benefits to the employee and (iv) ownership (engagement levels).

(ii) Considering all these options/variations, it is felt that ESOP is the most appropriate option for CPSEs as it is not expected to increase financial burden on the enterprise and the employees stand to gain significantly, in the long run, if they continue to be with the company.

(iii) The extent of dilution has to be considered since the major shareholders interest would be affected to that extent and this should not have any significant change in the equity structure.

(iv) Considering competitiveness of an organization being dependent more on availability of talent, stock options as a piece of ownership and commitment towards organization, are a necessity.

3.5.4 VOLUNTARY RETIREMENT SCHEMES

This paper was prepared by MMTC. It is a Social Security Scheme by Government/CPSEs for their employees by way of an option for voluntary retirement from service on personal grounds. It also helps CPSEs to rationalize their excessive manpower. The catch is to have a VR scheme attractive enough to encourage employees to quit and yet enable CPSEs to retain the necessary talent. Existing VR schemes prevailing in different forms and shapes suiting to the specific industry and in line with DPE guidelines or with certain modifications reveal that over the years, the significance and utility of the same has gone down considerably and there is a need to go for exploring other better options to make VR schemes attractive in future. Some of the alternative schemes suggested were as follows;

(i) Option A – ex gratia benefit of 90 days for each completed year of service. 45 days salary to be paid in lump sum and with the balance purchase annuity from LIC or wages/salary for the residual months of service whichever is less.

(ii) Option-B –

- Ex-gratia @ 60 days salary for each completed year of service or the balance months of service, whichever is less.
- Pension by way of LIC annuity @ 50% of last drawn salary till the date of attaining the age of superannuation.

(iii) Option-C – Under this option, no change in the ex-gratia is proposed. However, to make the scheme more attractive, it is suggested that Income Tax on ex-gratia amount be totally withdrawn.

(iv) Option-D – Autonomy may be given to consistently profit making and financially sound CPSEs to devise their own Voluntary Early Retirement (VER) Scheme according to their organizational requirements.

(v) National Renewal Fund (NRF) option – NRF assistance to be given to only such CPSEs that have carried out scientific manpower planning study.

(vi) Compulsory Retirement Scheme (CRS)- The performance of inefficient employees be evaluated on the basis of Performance Appraisal System for one year and if the rating is found to be 'Poor' or 'Fair' during the first year, the employee should be counseled, and if required can be deployed to some other area of work and imparted training accordingly. His performance for the next (2nd) year should be assessed and if performance doesn't improve, he should be cautioned with the warning that if his performance does not improve during the next assessment year then he may be compulsorily retired. In the 3rd year, if the performance has still not improved, then the employee should be retired under the CRS with certain benefits.

(vii) The essential requirement is to make the organization lean so that it becomes competitive. Public Sector enterprises have to compete with private sector and MNCs, which are run much more efficiently. To survive, Public Sector Enterprises will have to right size their manpower.

3.5.5 POST RETIREMENT BENEFITS

This paper was submitted by NALCO. Post retirement benefits include provident fund, leave encashment gratuity, pension post retrial medical facilities, etc.

(i) Retired employees of many CPSEs are left with little or no economic support as most CPSEs do not have any post retirement benefit schemes. As a measure of social security and also considering the fact that retiring employees have contributed to the company some schemes need to be put in place, which will provide regular income or support after retirement. This will give a sense of pride and independence, which these employees would have enjoyed, when they were regular employees. Whether it is a pension scheme better than EPS95 or enhanced gratuity or post retrial medical facility, etc. should be in the form of annuity purchased from LIC or any similar agency. Depending on the capacity of the company, the expenses could be shared between the company and the employee during the course of employment. Better performing CPSEs could share a larger proportion and in those CPSEs that are not doing well, the major portion could be from the employees themselves. The company is anyhow bound to contribute the statutory requirement towards PF, EPS 95 and gratuity.

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